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In the Supreme Court of the United States

OCTOBER TERM, 1935

No. 350

NORTHWESTERN BELL TELEPHONE COMPANY,
Appellant,

vs.

NEBRASKA STATE RAILWAY COMMISSION,
Appellee.

APPEAL FROM THE SUPREME COURT OF THE STATE OF NEBRASKA

BRIEF FOR APPELLANT

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NORTHWESTERN BELL TELEPHONE COMPANY,
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NEBRASKA STATE RAILWAY COMMISSION,
Appellee.

BRIEF FOR APPELLANT

The appellant prosecutes this appeal from a judgment of the Supreme Court of the State of Nebraska rendered March 1, 1935, which became final on May 4, 1935, by reason of the denial on that date of a motion for a rehearing. This judgment affirmed an order of the appellee Commission made on April 9, 1934, purporting to fix the depreciation rate to be used by appellant in its accounting for the year 1934 at 3½ per cent upon all its depreciable property in the State of Nebraska.

OPINIONS IN THE COURT BELOW

The opinion of the Supreme Court of Nebraska in this cause was filed March 1, 1935, and is reported in *In re Depreciation Charges for Class A and Class B Telephone Companies: Northwestern Bell Telephone Company v. Nebraska State Railway Commission,* 128 Neb. 447, 259 N. W. 362 (R. 216-221).

This decision affirmed an order of the Nebraska State Railway Commission, which, with its accompanying report or opinion, is not officially reported, but which may be found reported in *Re Northwestern Bell Telephone Company,* 5 P. U. R. (N. S.) 20 (R. 19-31). Previous orders of the Commission in the same proceeding to which reference will be made are not officially or otherwise reported, except that the opinion or report of the Nebraska Commission which accompanied its order of November 29, 1933, hereinafter referred to, is reported in *Re Depreciation Charges for Telephone Companies,* 1 P. U. R. (N. S.) 264 (R. 2-10).

JURISDICTION

Appellant has complied with paragraph 1 of Rule 12 of the rules of this Court, and pursuant thereto has filed a separate statement disclosing the basis upon which it is contended that this Court has jurisdiction upon this appeal to review the judgment of the Supreme Court of Nebraska. The Court has noted probable jurisdiction.

STATEMENT OF THE CASE

The proceeding which culminated in the order of the Nebraska Commission (the Appellee) here in question (the order of April 9, 1934, above referred to) was initiated by the Commission by an order styled "General Order No. 59, In the Matter of Depreciation Charges for Class 'A' and Class 'B' Telephone Companies," entered on November 29, 1933 (R. 2-10).

This initial order corsists of a preliminary statement of seven pages (R. 2-9) and the *order proper* (R. 9-10).

Since an understanding of this initial order is important in its bearing upon the argument herein, a brief statement of its salient features should be made at the outset.

Summary of General Order No. 59

The statement accompanying General Order 59 refers to the authority vested in the Interstate Commerce Commission to regulate the accounting of telephone companies subject to the Interstate Commerce Act, and to the system of accounts which had been prescribed to be used by such companies on and after January 1, 1913. Section 20, Par. (5) of the Interstate Commerce Act was amended in 1920 to require the Interstate Commerce Commission to prescribe "the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property * * *." The statement refers to this amendment and to the proceedings had before the Interstate Commerce Commission looking toward the carrying out of this mandate of Congress which culminated in the final order of the Commission on July 28, 1931. *Depreciation Charges for Telephone Companies,* 177 I. C. C. 351.

As was pointed out in the statement referred to, the Interstate Commerce Commission had required Class A telephone companies, of which appellant is one, to file

on or before August 1, 1934, with state commissions having jurisdiction, estimates of composite depreciation rates for each of twelve classes of property specified as depreciable, in accordance with principles of estimate and calculation prescribed by the Interstate Commerce Commission. The purpose of the Interstate Commerce Commission to be accomplished by these filings with state commissions was to secure the consideration thereof by the state commissions and to procure from them recommendations as to proper rates of depreciation to be adopted by the Interstate Commerce Commission. The further procedure was stated as follows by the Interstate Commerce Commission:

> "After consideration of the recommendations of the State commission or commissions to the extent available, this Commission will by a temporary order prescribe the composite annual percentage rates which shall be charged with respect to each class of depreciable telephone plant." (Exhibit 7, R. 211; 177 I. C. C. 351, 446.)

The statement of the Nebraska Commission also recites the fact that the Interstate Commerce Commission had prescribed for use by Class A telephone companies on and after January 1, 1933, a Uniform System of Accounts for Telephone Companies, First Revised Issue (Exhibit 7). This accounting system included as instructions for depreciation accounting the same principles and provisions which had been adopted by the Interstate Commerce Commission as a part of the depreciation order of July 28, 1931. In postponing certain effective dates of the depreciation order, the Interstate Commerce Commission had expressly provided that such postponement should not relieve companies from accounting for

depreciation in the manner required by the system of accounts (R. 5). Reference is then made to Interstate Commerce Commission Depreciation Section Circular No. 7 requesting telephone companies to file with the Interstate Commerce Commission not later than March 1, 1934, a schedule of depreciation rates by primary accounts which the companies proposed to use during 1934, together with a statement of estimated service lives and salvage value "based upon the best information readily available" but without the supporting detail which had been required to accompany the filings to be made with the state commissions on or before August 1, 1934 (R. 5).*

Under the heading of "Jurisdiction" the Nebraska Commission in the statement accompanying the order of November 29, 1933, then discusses the federal statutes and the action taken pursuant thereto relating to depreciation accounting, and states its understanding of the authority of the state and federal governments respectively in this field (R. 6-8). Under the heading of "Procedure" the Nebraska Commission then stated:

> "The Commission is of the opinion and so finds that the procedure adopted by the Interstate Commerce Commission, for prescribing depreciation rates, should be adopted by this Commission, except that when the Interstate Commerce Commission shall have prescribed the rate of depreciation after hearings by this Commission and the recommendations of this Commission thereon, the said rate should not be final, as far as accounting to this Commission is concerned, but subject to review by this Commission and a final order entered thereon." (R. 9.)

* The Nebraska Commission misinterpreted this requirement of the Interstate Commerce Commission as calling for the filing of March 1, 1934, to be made with the state commissions (R. 7).

Further in this connection the Nebraska Commission stated that the principles which had been enunciated by the Interstate Commerce Commission in its depreciation proceedings "should be adopted by this commission as a basis for depreciation accounting" (R. 8).

Upon the basis of the recitals which have been summarized above, the Nebraska Commission, by its order of November 29, 1933, directed appellant, together with other Class A and Class B telephone companies, to file with the Nebraska Commission on or before March 1, 1934, a schedule of depreciation rates for use in 1934, together with such data as had been required by the Interstate Commerce Commission to be filed with it at that time. Furthermore, appellant with other Class A telephone companies was directed to file with the Nebraska Commission on or before August 1, 1934, the proposed rates to be used on and after January 1, 1935, in accordance with the requirements of the Interstate Commerce Commission as set forth in the order of that body of July 28, 1931, 177 I. C. C. 351, and of the Uniform System of Accounts, Instruction 80 (Exhibit 7, R. 210-211), and supplemental orders postponing the effective dates of these requirements. Paragraph 4 of the order of the Nebraska Commission of November 29, provided:

> "4. That the procedure adopted by the Interstate Commerce Commission for prescribing depreciation rates be and the same is hereby approved, except that this Commission reserves the right to review the findings and conclusions of the Interstate Commerce Commission and enter a final order thereon as to the depreciation rate for accounting purposes to this Commission." (R. 9-10.)

The foregoing rather extended statement of the recitals contained in the order of November 29, is made for the reason that the recitals thus restated here constitute facts material to consideration upon this appeal, and for the further reason that the statement of them in the order of the Nebraska Commission is in itself a material consideration to be examined in connection with the inquiry whether the order here appealed from could validly be made consistently with requirements of due notice and right to a hearing constitutionally guaranteed to the appellant.

Within the time directed by the Commission the appellant filed with it the schedule of depreciation rates proposed to be used in 1934 and supporting data in accordance with the requirements of the November 29th order (R. 9) directing that such material be filed on or before March 1, 1934.

These schedules set out the depreciation rates for each of twelve classes of property which had been specified by the Interstate Commerce Commission as subject to depreciation accounting (R. 10-17). This filing indicated for each such class of property the service lives and the percentages of salvage which were employed in computing the depreciation rates. These estimates and computations were made according to the methods prescribed by the Interstate Commerce Commission in its order in the depreciation proceeding and in the accounting system which it had made effective in 1933. These percentage rates are applied in computing depreciation to the investment in the several primary accounts to which they relate, and thus is derived for each account

the amount representing the expense of depreciation associated with the property embraced in that account. The total of these amounts is the total annual depreciation expense on account of all depreciable property. This total may be related to the aggregate investment in the twelve accounts covering depreciable property. The filing of March 1, 1934, showed that the dollars of depreciation produced by the application of the twelve different rates to their several accounts amounted to 4.48 per cent of the total investment in depreciable property as of January 1, 1934. The Commission speaks of this as appellant's proposed rate (R. 30). No such composite rate is actually employed in depreciation accounting, nor can it be consistently with the federal accounting system.

Order for Hearing

On March 6, 1934, the Nebraska Commission made and entered, and caused to be served upon appellant, an order in the following terms:

> "Pursuant to our order of November 29th, 1933, the Northwestern Bell Telephone Company has filed with the Commission its schedule of depreciation rates by primary accounts which it proposes to apply for the year 1934, together with the supporting data as required by the Interstate Commerce Commission in Schedules 1 and 2 of Circular 7, Depreciation Section Series, and the same having been examined by our Engineering staff and not being fully satisfied with the rates proposed, we find that the cause should be set down for hearing for oral examination of the members of respondent's staff, who prepared said schedules, and for the introduction of such evidence the Commission may desire to submit with opportunity of objections and cross-examination by respondent,

> "IT IS THEREFORE ORDERED that the cause be set down for hearing on the 19th day of March, 1934, at the hour of 10 o'clock A. M. at the Commission's hearing room in the State Capitol." (R. 17-18.)

Pursuant to this order, appellant caused the members of its staff who had to do with the preparation of the schedules which had been filed, to appear before the Commission on March 19th as directed, and these witnesses tendered themselves to the Commission for oral examination as directed by the order. At the opening of this hearing appellant's counsel stated to the Commission that appellant was then engaged in assembling and arranging the material which would constitute the data supporting its depreciation rates, and which both the Interstate Commerce Commission and the Nebraska Commission had required to be filed on or before August 1, 1934. It was stated that in view of the date thus fixed, this material was not then ready for presentation and consequently appellant would not undertake at that time to make any complete affirmative showing in support of its rates of depreciation, but construed the order of March 6th as directing the production of the persons who had compiled the summarized schedules required to be filed March 1, and that such witnesses were present and ready to answer such questions as might be asked them (R. 43, 45, 46). Accordingly a variety of questions were asked by the Commission and its representatives of Mr. T. H. Granfield, the appellant's Inventory and Costs Engineer, who had had charge of preparing the schedules, and of Mr. R. P. Baird, the Company's General Auditor. This hearing occurred on March 19th and March 20th, and was confined to the answering of questions and the

making of such explanations as the Commission and its Engineer requested of these witnesses. Following this, the Commission caused certain exhibits of its own to be introduced in evidence, which are part of this record as Exhibits 3, 4, 5 and 6 (R. 191-200). The Commission then requested the appellant to furnish certain further data after the adjournment of the hearing, which request was complied with (R. 151-153), and the hearing adjourned.

The appellant offered no evidence in its own behalf and there was no argument of any question before the Commission on that occasion. It was not considered by appellant or suggested by the proceedings that there was any issue before the Commission as to which either evidence or argument could be directed, but on the contrary, the character of the proceedings was plainly limited to the scope fixed by the order of March 6, that is, the oral examination of designated persons by the Commission and the submission of such evidence as the Commission might desire to introduce.

Order Appealed From

On April 9, 1934, the Nebraska Commission made and entered the order appealed from. This order as modified by a subsequent inconsequential change in phraseology, was in the following terms:

> "IT IS THEREFORE ORDERED by the Nebraska State Railway Commission that the composite depreciation rate of the Northwestern Bell Telephone Company be and the same is hereby fixed at 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934.
>
> "IT IS FURTHER ORDERED that the Northwestern Bell Telephone Company be and is hereby directed to

use a composite rate of 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934, for purposes of accounting and reporting to the Nebraska State Railway Commission." (R. 30-31, 35.)

It was accompanied by an opinion and findings (R. 19-30).

Motion for Rehearing Before Commission

Appellant promptly filed a motion to vacate the order and for a rehearing or a new trial. In this motion (R. 31-32) appellant asserted that the order was made without proper notice or hearing and was therefore invalid; that the Commission had no jurisdiction to make such an order inasmuch as it was in conflict with properly exercised federal authority; and that it was not sustained by the evidence and was contrary to law. The Commission set this motion down for oral argument, but on May 15, 1934, overruled the motion, one commissioner dissenting (R. 34-41).

Appeal to Nebraska Supreme Court

Thereupon appellant took an appeal to the Supreme Court of Nebraska pursuant to the statutory provisions providing for a review of orders of the Commission under Section 75-505, Compiled Statutes of Nebraska, 1929. Substantially the same contentions were urged by appellant before the Supreme Court as have been enumerated above, as the grounds of its motion for a rehearing before the Commission. In an opinion filed March 1, 1935, the Supreme Court of Nebraska affirmed the order of the Commission and the appeal to this court followed in due course after the making and overruling of a motion for rehearing before the Nebraska Supreme Court.

SPECIFICATIONS OF THE ASSIGNED ERRORS HEREIN URGED

1. The Supreme Court of Nebraska erred in holding the order of April 9, 1934 valid as against the contention that it violated the rights of appellant under the Fourteenth Amendment in that the order was made without notice to appellant and without affording to appellant an opportunity to be heard. Assignment of Error No. 1 (R. 224).

2. The Supreme Court of Nebraska erred in affirming said order as against appellant's contention that the regulation of the subject matter there involved had been vested by Congress exclusively in the Interstate Commerce Commission, and the Interstate Commerce Commission had fully covered the regulation of the accounting of appellant, thereby precluding any regulation of the same matter by state authority. Assignment of Error No. 2 (R. 224-5).

3. The Supreme Court of Nebraska erred in affirming the order as against appellant's contention that the order was invalid because in conflict with valid and binding regulations and requirements imposed upon appellant by the Interstate Commerce Commission. Assignment of Errors Nos. 3 and 4 (R. 225).

4. The Supreme Court of Nebraska erred in affirming said order as against appellant's contention that it deprived appellant of its property without due process of law in that the order prescribed the use of a depreciation rate without any evidence to support the propriety of such rate; in that appellant was thereby deprived of the right to keep a true record of the expenses of its

business; and in that the method adopted by the Commission in determining upon the depreciation rate prescribed, was unsound and upon its face calculated to produce a rate other than the true rate of depreciation. Assignment of Errors 5, 6 and 7 (R. 225-226).

ARGUMENT

Summary of Argument

I. The order is invalid because it was made in disregard of the requirements of due process of the Fourteenth Amendment of the Constitution of the United States, in that said order was made without such notice and hearing as is thereby guaranteed to appellant.

A. The Nebraska Commission was bound to observe the requirements of procedural due process as to notice and hearing because upon any judicial review of the order all questions must be decided upon the record made before the Commission.

B. The requirements of due process respecting notice and hearing were not observed in the proceedings before the Commission.

1. There was no notice that the Commission contemplated the making of any order affecting the rates of depreciation to be used by appellant in its accounting in 1934.

2. On the contrary, the previous proceedings before the Commission were inconsistent with the making of such an order.

a. No purpose had been disclosed except to secure information for the purpose of making recommendations to the Interstate Commerce Commission.

b. The Nebraska Commission had adopted the principles and procedure contemplated by the Interstate Commerce Commission.

c. It could not make an order such as the one at bar consistently with the principles thus adopted.

d. It had expressly announced its intention to defer determining any issue as to conflicting state and federal jurisdiction until the Interstate Commerce Commission should have finally fixed rates of depreciation.

3. The proceedings did not afford appellant a legally sufficient hearing.

a. There being no notice adequate to support the order, the hearing held pursuant to the particular notice given was insufficient because it was not a hearing upon the matters which should have been heard to justify the order.

b. Appellant had no opportunity to make a showing by evidence or argument as to the legality or propriety of such an order.

4. There was no waiver by appellant of the insufficiency of notice or hearing because such insufficiency did not appear until the order was made.

II. The order is invalid because it was beyond the power and jurisdiction of the Nebraska Commission under the Constitution of the United States for the reason that the action already taken by the federal government respecting the accounting by appellant for depreciation, completely occupied the field of regulation of that subject and precluded any regulation thereof by state authority.

A. Federal statutes and regulations discussed.

B. The validity of such federal regulation of accounting of carriers engaged in interstate commerce, respecting both local and interstate business, has been established.

C. The order here in question is an attempted regulation of accounting of such a carrier.

D. The authority exercised by Congress and by the Federal Commission under its authority respecting the regulation of accounting of such carriers makes invalid the action attempted to be taken by the order here under consideration.

III. The order is invalid under the Constitution of the United States because it is in conflict with valid regulations of the Interstate Commerce Commission relating to the same subject.

A. Particular federal requirements considered.

1. Accounting separately by classes of plant.
2. Straight-line depreciation accounting.
3. Depreciation rates to be based on estimated service values and service lives.

IV. The order is invalid under the Fourteenth Amendment because

A. It deprives appellant of the right to maintain true and accurate records of the expenses of its business;

B. It is not supported by any substantial evidence, and

C. It requires the use in the accounts of appellant of a depreciation rate which was less than the true rate for the sole purpose of reducing the balance in its depreciation reserve account.

I.

THE ORDER APPEALED FROM IS VOID UNDER THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT OF THE CONSTITUTION OF THE UNITED STATES BECAUSE IT WAS MADE WITHOUT NOTICE TO APPELLANT OF THE ISSUE TO BE EXAMINED AND OF THE NATURE OF THE ACTION CONTEMPLATED, AND WITHOUT AFFORDING TO APPELLANT AN OPPORTUNITY FOR HEARING THEREON.

A.

The Nebraska Commission could not validly make the order in question without observing the requirements of due process as to notice and hearing for the particular reason that under the Statutes of Nebraska any judicial review of the order must be had solely upon the record made before the Commission.

Under the provisions of Compiled Statutes of Nebraska, 1929, Section 75-505, the method of judicial review of such an order is by an appeal to the Supreme Court. This section of the statute provides:

> "The evidence presented before the railway commission, as reported by its official stenographer and reduced to writing, shall be duly certified to by the stenographer and the chairman of the railway commission as the true bill of exceptions, which, together with the pleadings and filings duly certified in the case under the seal of the railway commission, shall constitute the complete record and the evidence upon which the case shall be presented to the appellate court."

It results from this that the parties concerned must make before the commission whatever record is to be made in such proceeding. This scheme of review of administrative orders is too commonly employed to require any special comment. However, the consideration is inevi-

tably associated with this method of procedure that any denial of procedural due process before the commission is final. A proper notice must there be given or it can never be given. A proper hearing must there be had or in the nature of things it will never be had. If these incidents of a procedure in accordance with due process of law are not observed by the commission, then there has been a final failure to observe them in making up the only record which can be considered upon a judicial review of an order. These rights in that case have been denied at the only point which the state has chosen to provide for their exercise.

It is clear that if in any particular proceeding the Nebraska Commission is permitted to make orders affecting important property rights without itself observing the essentials of due process in its procedure, there has been an unconstitutional deprivation of rights in this regard. Compare *Oregon R. R. & N. Co. v. Fairchild*, 224 U. S. 510, 524-526.

B.

The requirements of due process respecting notice and hearing were not observed in the proceedings before the Commission.

Any right of the appellant to test judicially the legality of such an order as the one here in question must be made upon the record before the Commission. No other evidence may be introduced or considered. It necessarily follows from this that appellant cannot be precluded by such an order unless it was notified in advance of what the issue was which was to be heard, and in respect to which evidence was to be adduced.

In this connection this court took occasion to say in *Oregon R. R. & N. Co. v. Fairchild,* supra:

> "The defendant insists, however, that, no matter how complete the right to be heard before the Commission, the statute having denied all other opportunity for testing the validity of the order in the state courts, furnished an utterly inadequate judicial review because, as the carrier could not anticipate what decision would be made, it was unjust to require it to produce evidence, to show in advance, the unreasonableness of an order, the terms of which were not known. From this it argues that the statute was unconstitutional in so far as it prevented the court from receiving competent and non-cumulative testimony tending to prove that there was no public necessity for making the track connection and that the order was void.
>
> *"This position would be true if the defendant had not been put on notice as to what order was asked for and then given ample opportunity to show that it would be unjust or unreasonable to grant it.* In this case under the statute, it was given such notice." (Italics ours.) 224 U. S. at pp. 525-526.

1.

There was no notice in this proceeding that the Commission had in contemplation the making of any order affecting the accounting in 1934 by appellant for the expense of depreciation.

The document which set the matter down for hearing on March 19 and 20, 1934, has been quoted in the foregoing statement of facts in this brief and is found at pages 17-18 of the printed record. It set the pending matter, whatever it was, down for hearing at a specified time for the oral examination of certain designated persons who had prepared some schedules filed with the

Commission, and for the introduction of evidence by the Commission. The preceding course of this matter before the Commission had given it a well defined character as one looking toward the making of recommendations by the Commission to the Interstate Commerce Commission. The order for the hearing of March 19 set this "cause" down for hearing at that time.

The notice does not contain any charge or complaint of any character. It does not assert that appellant is doing or contemplating anything unlawful or anything which the Commission has either the wish or the power to correct or remedy. In short, there is nothing in this notice which suggested any controversy between any persons whatever, or any issue to be tried or determined. The notice refers to the filing of certain proposed schedules of depreciation rates by appellant, and recites that the Commission is not fully satisfied. This surely falls far short of suggesting any issue which was to be resolved by the making of an order by the Commission. It will be remembered that the request of the Interstate Commerce Commission in compliance with which the filing of March 1, 1934 was made, contemplated only the furnishing of such data as to service lives and salvage values as might be "readily available" (R. 5), and was not designed to "satisfy" any one in the sense of making out a case for their approval by public authority. This was left for the filings to be made August 1, 1934. The statement referred to is properly consistent only with the continuance of the declared purpose of the Commission to inform itself as to these matters to the end which it had previously very fully set forth.

2.

The Order of November 29, 1933, of the Nebraska Commission giving notice of the proceeding and the whole course of the proceedings in the matter then before it were inconsistent with the making of the order appealed from.

In this connection we direct attention to the order of November 29, 1933, which initiated the proceeding in the course of which the order appealed from was made, and which fully set forth the nature and purpose of the proceeding. In the foregoing statement of facts we have set out the statements contained in this order and in the opinion on which it was based. The purpose of the proceeding is thereby fully and clearly disclosed.

(a)

The purpose of the proceeding had been disclosed to be that of securing information for the purpose of making recommendations to the Interstate Commerce Commission, and no other purpose had been suggested.

Ever since January 1, 1913, telephone companies engaged in interstate commerce, and therefore subject to the Interstate Commerce Act, have been required by the Interstate Commerce Commission to keep their accounts in accordance with the uniform system prescribed by the Federal Commission. This was under the authority of Section 20, Paragraph (5) of the Interstate Commerce Act, 49 U. S. C. A. Sec. 20, Par. (5), and Sec. 20, Par. (1). Under this system of accounts telephone companies were directed to account for depreciation and certain rules and principles were established in accordance with which such accounting should be performed.

By the Transportation Act of 1920 an amendment was adopted to Section 20, Paragraph (5) of the Interstate Commerce Act, which inserted the following provision:

> "The commission shall, as soon as practicable, prescribe, for carriers subject to this chapter, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this chapter shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses."

Although the Interstate Commerce Commission had, as indicated above, previously prescribed rules in accordance with which depreciation accounting should be done, it had never undertaken to prescribe the specific rate or rates of depreciation which should be employed. The amendment of 1920 required that it proceed to specify the classes of property which were to be treated as depreciable and the specific rates of depreciation to be charged with respect to each. Extensive hearings were held. A series of intermediate reports and a final report and order were made. The latter is *In the Matter of Depreciation Charges for Telephone Companies,* 177

I. C. C. 351. At this time the Commission determined the classes of property as required by the Act and made elaborate findings and laid down detailed rules and principles to be followed in calculating depreciation rates.

Looking to the actual establishment of such rates by the Interstate Commerce Commission the carriers affected were directed to file with state commissions on or before specified dates, estimates of the percentage rates applicable to the several classes of property, such estimates to be made in accordance with the principles established by the Interstate Commerce Commission and to be accompanied by a sworn statement showing the underlying data upon which they had been computed. 177 I. C. C. 445, 446. It was contemplated that state commissions upon the basis of the filings so made would make recommendations to the Interstate Commerce Commission, which would then proceed to make a temporary order fixing rates, and subsequently after public hearings, if necessary, a final order fixing rates. 177 I. C. C. 446. Effective January 1, 1933, the Interstate Commerce Commission prescribed a revised accounting system for telephone companies (Exhibit 7, R. 201-214). In this accounting system the principles and procedure for determining depreciation rates as above outlined were made a part of the accounting regulations.

Orders were subsequently made postponing from time to time the dates when filings with the state commissions were to be made, and at the time with which we are concerned, such filing was to be made August 1, 1934. The order of the Nebraska Commission of November 29, 1933, dealt with this procedure and indicated the

determination of the Commission to perform the functions contemplated by the order of the Interstate Commerce Commission, that is, to make recommendations to the Interstate Commerce Commission. It added the sanction of its order to that of the Interstate Commerce Commission with respect to the filing of proposed rates and data supporting the same with the Nebraska Commission.

As appears from the previous description of this order the Nebraska Commission had plainly characterized the proceeding which it then initiated as one designed to co-operate with the Interstate Commerce Commission in enabling the latter to carry out the mandate of Congress and prescribe depreciation rates.

(b)

The Nebraska Commission adopted the principles and procedure which the Interstate Commerce Commission had laid down.

It is not necessary in this connection to do more than refer to the provisions of the order of November 29, 1933, as they have already been summarized and quoted in this brief, to have it clearly appear that the Nebraska Commission was at pains to be explicit in placing itself in complete harmony for the purposes of this proceeding with the principles and regulations of the Interstate Commerce Commission. The pertinency of this fact in this connection is that with this background appellant was entitled to expect that unless the Nebraska Commission evidenced some change in its purpose it would make no orders or impose no requirements inconsistent with those

which had been promulgated by the Interstate Commerce Commission.

(c)

The present Order is inconsistent with the principles and requirements of the Interstate Commerce Commission and is therefore inconsistent with the principles which the Commission had in this very proceeding formally announced that it embraced and adopted.

We leave for more elaborate discussion in connection with another ground of attack upon this order, the conflicts between this order and the requirements of the Interstate Commerce Commission. For the bearing of these inconsistencies upon the matter of due notice, we only refer summarily to them at this time. It will be sufficient now merely to point out:

1. The requirements of the Interstate Commerce Commission respecting depreciation accounting impose the necessity of employing a separate rate for each of twelve classes of property (R. 211, 213). The order of the Nebraska Commission requires the employment of a single rate for all depreciable property.

2. The requirements of the Interstate Commerce Commission are that each of such rates be computed upon the basis of estimated service lives and salvage values (R. 211). The order in question requires the use of a rate which has no demonstrable or even conceivable basis in estimated service values and service lives, but on the contrary, as the report of the Commission discloses, is arrived at upon entirely different principles.

3. The Interstate Commerce Commission requires that depreciation rates be computed in accordance with the straight-line method of depreciation accounting (R. 211). The Nebraska order disregards this requirement and requires the employment of a rate which necessitates a departure from straight-line depreciation accounting.

Thus it is seen that the effect of what had taken place was that appellant had been plainly notified by the Commission that whatever it did would be in accordance with the principles of depreciation accounting which had been established by the Interstate Commerce Commission and would be for the purpose of making recommendations to that Commission. What it in fact did was to make an order having no function in connection with making recommendations to the federal Commission, and which was in almost every essential particular at variance with these principles.

(d)

The Nebraska Commission had clearly announced its intention to make no order having to do with any question as to jurisdiction as between State and Federal authority until after the fixing of rates of depreciation by the Interstate Commerce Commission had been fully accomplished.

The order of November 29, 1933, declared, in Paragraph 4 of that order, that the Nebraska Commission approved the procedure adopted by the Interstate Commerce Commission reserving only "the right to review the findings and conclusions of the Interstate Commerce Commission and enter a final order thereon as to the depreciation rate for accounting purposes to this Commission" (R. 9-10). There could scarcely have been

enunciated a clearer or more definite statement of what the Commission was about, nor could there have been a more definite assurance to parties concerned that until the Interstate Commerce Commission had acted, the Nebraska Commission would not undertake to impose requirements which might be at variance with those of the federal Commission, and thereby subject such parties to the oppression which is always incident to an attempted exercise of authority by two conflicting jurisdictions respecting the same subject matter.

3.

Appellant was not given a hearing which satisfies the requirements of due process.

The character of the hearing which preceded the making of this order is not to be divorced from the character of notice which preceded the hearing. The insufficiency of the hearing resulted primarily from the fact that appellant had been given no notice sufficient to advise it that an order regulating depreciation accounting was in contemplation at all. It is elementary that a constitutionally sufficient hearing must afford an opportunity to a party to address itself by evidence and argument to the issue or issues which are to be resolved by the decision of the particular tribunal. Of course, a hearing may be adequate to deal with one matter and yet entirely inadequate to support an order dealing with some foreign issue or consideration. Appellant did not have a proper hearing in this case because it had not been advised that the occasion for the hearing had anything to do with an order of the kind which the Commission issued and therefore had no opportunity to present evidence or make argu-

ments as to either the legality or propriety of the making of such an order.

Moreover, the order of March 6, 1934, which set the matter down for hearing, is worthy of attention in this respect (See supra, p. 9). This order did not call upon appellant to show cause with respect to any question or set down any specified issue for hearing. On the contrary, it simply directed the production of certain individual witnesses for questioning by the Commission, and stated that the Commission might present evidence. It can scarcely be considered an adequate hearing in any case where the tribunal selects the witnesses and limits the evidence to that which it sees fit to introduce. Compare *Whitfield v. Hanges,* 222 Fed. 745, 749. This court said in *The New England Divisions Case,* 261 U. S. 184, at p. 200:

> "A full hearing is one in which ample opportunity is afforded to all parties to make, by evidence and argument, a showing fairly adequate to establish the propriety or impropriety, from the standpoint of justice and law, of the step asked to be taken."

4.

There was no waiver by appellant of its right to proper notice and a full hearing by its participation in the proceedings which were had.

The point in this connection is that the notice and the hearing were entirely appropriate to the proceedings at that time pending before the Commission. The Commission had initiated a proceeding for the purpose of assembling information and acquainting itself with the matter of appellant's depreciation rates with the end in view of making recommendations to the Interstate Com-

merce Commission. It had elaborately so described the matter in its order of November 29, 1933. One step in the course of the proceedings looking to the ultimate establishment of depreciation rates by the Interstate Commerce Commission, involved the filing on or before March 1, 1934, of rates proposed to be used during that year. At this stage the Nebraska Commission, having these data before it, directed appellant to produce certain witnesses at a hearing which it proposed to conduct. This was well within the bounds of action contemplated by all of the parties as a part of what the Nebraska Commission was engaged in doing.

Appellant construed this hearing as possessed of the same underlying character which the proceedings had had since their institution. There was nothing in the order setting the matter down for hearing which intimated that the proceedings had changed or that anything was involved other than the steps previously contemplated of placing the Nebraska Commission in a position to make recommendations to the Interstate Commerce Commission.

The hearing of March 19 and 20, 1934, simply carried out what the notice of the hearing had foreshadowed. Appellant had no objection to this procedure and readily co-operated in the furnishing of such information as the Commission at that time sought to elicit. The scope of the hearing was exactly what the appellant had been notified that it would be. The objection which now lies to the order in suit, the order of April 9, 1934, fixing a rate of depreciation, is that this order was outside the scope of both the notice and the hearing. It was not contemplated by either, or by the proceedings which had antedated the hearing.

Appellant promptly (April 12, 1934) filed a Motion for Rehearing (R. 31-2). This motion in the most definite manner called the Commission's attention to the foregoing glaring irregularity in the proceedings. It advised the Commission that no notice had been given to the company that the proceeding contemplated fixing a rate or rates of depreciation, or contemplated any action whatever by the Commission other than making its recommendations to the Interstate Commerce Commission. It pointed out that the only thing the Company had been notified to do was to present the members of its staff who had prepared the schedules for oral examination by the Commission. It asked that the order be set aside and the whole matter be reopened, so that the company might have an opportunity both to challenge the Commission's authority to make such an order and to present evidence to justify the depreciation rates it had filed. *This motion was denied.*

The character of this hearing was accurately described by the Commissioner who dissented upon appellant's application for a rehearing, in the following language:

> "It was common knowledge that the two day hearings on March 19th and 20th, 1934, were considered by members of the Commission as a 'school of instruction,' and by the respondent as a compliance to an order by the Commission to demonstrate to it some of the methods, plans, etc., which were going to be used in 'proving in' the life of property in hearings before the Interstate Commerce Commission. The respondent offered no testimony. The Commission questioned several of its employees as to the work they were doing. Certainly there was no hearing

which must be contemplated in view of any final order of this Commission." (R. 40-41.)

II.

THE ORDER APPEALED FROM IS VOID FOR THE REASON THAT THE ACTION ALREADY TAKEN BY THE FEDERAL GOVERNMENT RESPECTING THE ACCOUNTING BY APPELLANT FOR DEPRECIATION COMPLETELY OCCUPIED THE FIELD OF REGULATION OF THAT SUBJECT AND PRECLUDED ANY REGULATION THEREOF BY STATE AUTHORITY

The proposition which we are concerned to establish at this point is that the order appealed from is invalid for the reason that it is an attempt by state authority to regulate the business of an interstate carrier in an area which has been so far occupied by federal authority as to preclude state regulation.

When the order here being reviewed was made, appellant was subject to the Interstate Commerce Act. The validity of the order is to be tested by the considerations then pertinent.*

Congress had vested in the Interstate Commerce Commission full and complete power to prescribe and regulate the accounting forms and methods of telephone companies and others subject to the Interstate Commerce Act. Pursuant thereto the Interstate Commerce Commis-

* Later in 1934 the Federal Communications Act was enacted, (Act of June 19, 1934, c. 652, 48 Stat. 1064, 47 U.S.C.A. Secs. 151-609). Some later reference may be made to this Act, but in the course of the discussion to follow the matter is argued in the light of the federal statutes previously applicable, without taking occasion to notice whether federal requirements now have sanctions proceeding from statutes and orders superseding those by which this order must be tested.

It may be added that the Communications Act (Sec. 220) vests in the Federal Communications Commission the same authority over accounting in general and depreciation accounting in particular as the Interstate Commerce Act had previously vested in the Interstate Commerce Commission. This is of interest as indicating the continuing importance of the questions here presented for argument.

sion had prescribed a system of accounts for telephone companies subject to its authority. This accounting system, uniform as to companies of the classes affected, is a complete set of regulations dealing with the accounting of such carriers. It covers all the accounting of these companies. The Interstate Commerce Act, Section 20, Paragraph (5) and Paragraph (7), forbids carriers subject to the Act, under criminal penalties, to keep any other records or accounts than those prescribed or authorized.

By virtue of the action thus taken, the federal authority has completely occupied the field of regulating the accounting of carriers subject to the Interstate Commerce Act. The system prescribed is complete, and, by enjoining carriers from keeping any other accounts, the federal Act has made it plain that the system of accounts is to be free of interference from any source whatever. It follows that any state regulation of the same subject, i. e. the accounting of carriers subject to the Interstate Commerce Act, becomes legally impossible.

A.

Federal Statutes and Regulations considered.

Some reference has already been made in another connection to the pertinent provisions of the Interstate Commerce Act. By Act of Congress of June 18, 1910, telephone companies engaged in interstate commerce were made subject to the provisions of the Interstate Commerce Act. U. S. C. Title 49, Section (1), Paragraph (1) (c). Section 20, Paragraph (1), provides that the Interstate Commerce Commission

"may, in its discretion, for the purpose of enabling it the better to carry out the purposes of this chapter, prescribe a period of time within which all common carriers subject to the provisions of this chapter shall have, as near as may be, a uniform system of accounts, and the manner in which such accounts shall be kept." (U.S.C. Title 49, Sec. 20, Par. (1).)

Section 20, Paragraph (5), of the Interstate Commerce Act further provides:

"The commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this chapter, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys."

This paragraph further provides:

"* * * and it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed or approved by the commission, * * *." (U.S.C. Title 49, Sec. 20, Par. (5).)

Paragraph (7) of this section provides:

"Any person * * * who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the carrier's business, or shall keep any other accounts, records, or memoranda than those prescribed or approved by the commission, shall be deemed guilty of a misdemeandor and shall be subject, upon conviction in any court of the United States of competent jurisdiction, to a fine of not less than $1,000 nor more than $5,000, or imprisonment for a term not less than one year nor more than three years, or both such fine and imprisonment." (U.S.C. Title 49, Sec. 20, Par. (7).)

Pursuant to the authority thus conferred upon it, the Interstate Commerce Commission, effective January

1, 1913, prescribed a Uniform System of Accounts for Telephone Companies. Effective January 1, 1933, the Interstate Commerce Commission prescribed a revised system of accounts known as Uniform System of Accounts for Telephone Companies, First Revised Issue (Exhibit 7, R. 201-202). The order of the Commission placing this system in effect prescribed the same for use of telephone companies, including appellant, and ordered

> "that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts in conformity therewith." (R. 201.)

Whereas the original system of accounts had directed companies to account for depreciation in accordance with rules to be adopted by the accounting company, the revised system of accounts directed such companies to account for depreciation in accordance with elaborate rules prescribed in the system of accounts. This system of accounts directed that until specific rates of depreciation for each account should be prescribed by the Commission,

> "the company's estimates of composite annual percentage rates computed in accordance with instruction 80 shall be used prior to the date rates prescribed by this Commission become effective." (Instruction 81 (C), R. 212-213.)

Instruction 80 directed, among other things, the following:

> "These percentage rates shall be based upon the estimated service values and service lives developed by a study of the company's history and experience and such engineering and other information as may be available with respect to prospective future con-

ditions. These percentage rates shall be computed in conformity with the group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation (note instruction 3-J), may be distributed under the straight-line method (note instruction 3-Z) during the service life of the property. Such percentage rates shall for each primary account comprised of more than one class of property produce a charge to operating expenses for that account equal to the sum of the amounts that would otherwise be chargeable for each of the various classes of property included in the account." (R. 211.)

The result of the foregoing is that the Interstate Commerce Commission, pursuant to authority vested in it, had prescribed the forms and methods by which depreciation expense should be calculated for the purpose of accounting and the manner in which the accounting company should deal with it upon its books of account.*

B.

The Constitutional validity of Federal Regulation of the accounting of carriers engaged in interstate commerce, as respects all business both interstate and intrastate, has long since been established.

The action taken as disclosed by the foregoing recital of federal statutes and administrative regulations, discloses the sweeping nature of what has been done. The practical necessity of having but one system of accounts and but one source of regulation of the accounting of carriers engaged in both interstate and intrastate com-

* It may be proper to remark further that the Federal Communications Commission has revised the System of Accounts for Telephone Companies, effective January 1, 1936, and has provided for depreciation accounting and the computation of depreciation rates in accordance with the same principles which have been described above as having been adopted by the Interstate Commerce Commission.

merce is apparent in view of the fact that the same facilities and the same personnel are almost constantly engaged in both kinds of business. In the telephone business almost all property commonly thought of as provided for local use is at times used and is at all times available for use in interstate commerce. The two are inseparable. Compare *Cooney v. Mountain States Tel. & Tel. Co.*, 294 U. S. 384; *Board of Commissioners v. N. Y. Telephone Co.*, 271 U. S. 23. Consequently, the Interstate Commerce Commission in undertaking to regulate the accounting of carriers subject to its jurisdiction has never attempted to limit the scope of its requirements to the accounting for interstate business, but has, as would seem to be necessary, provided regulations covering the whole system of accounts of such carrier. The constitutional propriety of such regulation has long since been firmly established. *Interstate Commerce Commission v. Goodrich Transit Co.*, 224 U. S. 194; *Kansas City So. Ry. Co. v. United States*, 231 U. S. 423.

C.

The Order of the Nebraska Commission is an attempted regulation of accounting.

The order directed appellant "to use a composite rate of 3½ per cent upon all of its depreciable property in Nebraska including right-of-way, for the year 1934 for purposes of accounting and reporting to the Nebraska State Railway Commission." We may lay to one side the requirement as relating to the reporting to the Commission, and confront the direction to use the prescribed rate "for purposes of accounting." This plainly was a mandate as to how appellant should account for depre-

ciation upon its books. The proceeding in the course of which the order was made was concerned with depreciation expense solely as a matter of accounting. No proceeding was in progress or contemplated which related to charges to be made to the public for service.

The Supreme Court of Nebraska construed the order, as the parties before it also did, as a regulation of depreciation accounting (R. 217-219). *Northwestern Bell Telephone Co. v. Nebr. State Ry. Comm.*, 128 Neb. 447, 259 N. W. 362, 363, 364. The order as so construed is the order as it comes before this court. What the order called upon appellant to do was solely concerned with the entries to be made upon its books of account, and the reporting to the Nebraska Commission of what its books thus should reveal. The thing directed to be done was the making of accounting entries in a certain manner and upon the basis of calculations made in a prescribed fashion. Its validity must be tested in the light of the question whether the Nebraska Commission has the power to direct the manner and prescribe the basis upon which accounting entries covering depreciation expense shall be made. It is very plain that "depreciation" as it presents itself in this case is purely *depreciation accounting.*

It may be observed that the order of November 29, 1933 speaks of a "uniform system of accounting to the Interstate Commerce Commission" (R. 6), and of "depreciation charges for accounting purposes to this Commission" (R. 6). We do not undertake to interpret this language beyond saying that it seems to look to some system of multiple sets of accounting records maintained for the benefit of various regulatory bodies. Explaining

the concept which the Commission may have entertained perhaps helps to understand the order here being reviewed; but it cannot aid in sustaining it. The federal authority has regulated accounting, for whatever purpose accounting is done, and for the benefit of all to whom such accounts may be of any lawful concern. And it has expressly forbidden carriers to keep any other accounts or records.

A reading of the several orders of the Commission in this proceeding discloses a disposition to treat accounting as a function or part of the process of *reporting* to regulatory bodies. Of course, what a company is permitted to record may limit what it will be able to report. But accounting is a significant thing in itself. It has been made subject to federal regulation as an important function of a business which itself may properly be subjected to federal regulation, and not merely as a phase of making reports to commissions.

D.

The authority exercised by Congress and by the Interstate Commerce Commission pursuant to its authority has fully occupied the field of regulating the accounting of carriers engaged in interstate commerce and precludes any State action undertaking to regulate such accounting, and therefore the Order appealed from is invalid.

As the foregoing discussion discloses, Congress has authorized the Interstate Commerce Commission to prescribe the accounting methods to be employed by appellant and other carriers. The Interstate Commerce Commission has prescribed such accounting, including the calculation and recording of the expense of depreciation.

This action on the part of the federal authority not only covers fully the whole subject of accounting, but the provisions of the Interstate Commerce Act make it plain that the federal occupancy of this field should be exclusive. The institution of a "uniform system" of accounting, by the very force of these words, forbids the intrusion of authority by one or more of several states. Uniformity could not be expected long to withstand the effects of control by several different regulatory bodies. It must have been perfectly well understood that there are many plans and methods of accounting. The Interstate Commerce Commission could adopt a uniform system, or any system, only by the adoption of one of many alternative methods and the implied rejection of others. This is nowhere better illustrated than with respect to depreciation accounting. The existence of authority in one place to select and enforce the use of one method cannot be reconciled with the existence elsewhere of authority to select and enforce the use of a different one. In dealing with this question we are not left to inference as to whether Congress considered it desirable that a uniform system of accounting should prevail among carriers throughout the country. Compare *New York Central R. Co. v. Winfield*, 244 U. S. 147, 149, and dissenting opinion, p. 169. The thing which Congress has authorized the Interstate Commerce Commission to do is to make such accounting uniform.

If there were otherwise any question as to the existence in the states of any power to regulate any part or phase of the accounting of carriers subject to the Interstate Commerce Act, it would be removed by the provision of the Act forbidding carriers "to keep any other

accounts, records, or memoranda than those prescribed or approved by the Commission" (Sec. 20, Par. (5)). Congress could not have said more clearly that the regulations prescribed by the Interstate Commerce Commission should be exclusive.

It will be apparent from the foregoing statement of the argument, that appellant's position does not depend upon anything which is peculiar to depreciation as a subject of accounting. It is not the nature of the subject matter or facts that are to be recorded upon the books which is characteristic of the exercise of federal authority. Jurisdiction of accounting does not here depend upon jurisdiction to regulate the transactions which are being accounted for. Hence it is that the argument here made does not look for any essential foundation to the amendment of Section 20, Paragraph (5) of the Interstate Commerce Act by the Transportation Act of 1920, which directed the Interstate Commerce Commission to determine the classes of property for which depreciation should be charged as an expense, and to fix the rates of depreciation to be charged with respect to each class. See supra p. 21. Whether or not this amendment added anything to the authority previously possessed by the Commission, it must be admitted that there is no obstacle to its authority to prescribe the method of accounting, including the accounting for depreciation expense. The field that has been occupied is that of the regulation of accounting.

The completeness with which the federal government has undertaken the regulation of accounting of carriers subject to the Interstate Commerce Act would seem hard-

ly to leave any place for state action in this field. The only suggestion which has been made to the contrary looks for its authority to *Smith v. Illinois Bell Telephone Co.*, 282 U. S. 133. The Supreme Court of Nebraska decided this question adversely to appellant in reliance upon that case. We submit that this view proceeds from an essential misconception of what was there involved and decided.

It is important to keep clearly in sight the question with which we are dealing. Appellant's contention here is that Congress, pursuant to its authority to regulate interstate commerce, has, by statute and through its agency the Interstate Commerce Commission, prescribed the methods of accounting of telephone companies subject to the federal act. The action thus taken is such as to occupy this field and preclude any state regulation of accounting of such companies. The question now for consideration is whether the *Illinois Bell Case* stands in the way of accepting the result of this argument. In the present case we have urged the importance of seeing that the federal action taken is a regulation of accounting, complete and exclusive in character; and that the order of the Nebraska Commission is likewise an attempted regulation of accounting. They operate in the same field and deal with the same thing.

When we turn to *Smith v. Illinois Bell Telephone Co.*, it is found that the state action in question there was not a regulation of accounting at all. The authority asserted by the state was that of prescribing charges for intrastate service. No question existed as to the power of the state to function in this field. The determination by a

commission of proper charges for service, and the determination by a court of the validity of such charges, where challenged upon the ground of confiscation, involves the ascertainment of the expenses of furnishing such service, including the expense of depreciation. The question there was whether the state commission, or, as the matter then came up, the court resolving the issue of confiscation, should make its own findings as to the amount of the expense of depreciation, or whether by virtue of the federal action taken with respect to depreciation accounting the amount of depreciation expense was predetermined. The argument of the Telephone Company there was that in an intrastate rate case the matter was not open to independent investigation.

That contention was rejected by this court. The question was reserved for consideration when it might arise as to what the result would be after the Interstate Commerce Commission should have proceeded further in the performance of the duty imposed upon it by the amendment of 1920. The court said:

> "As the Interstate Commerce Commission has not acted finally in the matter, we are not now called upon to consider the scope of its authority in relation to depreciation charges, but we are of the opinion that, in any event, until action has been taken which could be deemed validly to affect the amount to be charged to depreciation in connection with intrastate business so as to affect intrastate rates, the prerogative of the State to prescribe such rates, and the jurisdiction and duty of the statutory court in considering their validity to determine the amount properly allowable for depreciation in connection with intrastate business, are not to be gainsaid." (282 U. S. 133, 159, 160.)

It is here apparent that on the face of the matter the state and federal actions which were claimed to be opposing one another dealt with different concerns. This court clearly recognized this when it said:

> "The Interstate Commerce Commission has its accounting rules with reference to depreciation charges and, pending its order under section 20 (5) of the Interstate Commerce Act, telephone companies, as well as others subject to the Act, have been directed to continue to observe these requirements." (282 U. S. 133, 159.)

There is no intimation of any concealed infirmity in the exercise of this authority by the Interstate Commerce Commission, nor any suggestion that it is not binding on the companies involved.

The application of these accounting rules prescribed by the Interstate Commerce Commission results in the calculation and entry of certain amounts upon the books of the company as the expense of depreciation. The specific rates from which directly this expense is calculated are computed by the accounting company in obedience to these rules, but the rates themselves have not been fixed by the federal commission. As matters stood when *Smith v. Illinois Bell Telephone Co.* was decided these accounting rules did not prevent independent findings as to depreciation in a rate case. Whether subsequent action by the Interstate Commerce Commission as described above in this brief has altered the premises then existing, it is not necessary to consider. This case does not involve the question as to what scope constitutionally belonged to a state commission on April 9, 1934 (the date of this order), in finding the expense of

depreciation as an incident to determining reasonable charges for intrastate service. The contention insisted upon here is that the method of *accounting* for depreciation has been regulated by federal authority; that the validity of this regulation has long since been established; and that in the face of this there is no room for any state regulation of the same subject matter. Certainly the holding of the *Illinois Bell Case* does not stand in the way of this conclusion, because no such question was there involved. And the language of that opinion, so far from suggesting underlying considerations at variance with this result, plainly assumes that the federal authority has dealt with depreciation accounting with the finality and exclusiveness which attends the proper exercise of federal power.

III.

THE ORDER OF THE NEBRASKA STATE RAILWAY COMMISSION, HERE IN QUESTION, IS VOID BECAUSE IT IS IN CONFLICT WITH VALID REGULATIONS OF THE INTERSTATE COMMERCE COMMISSION MADE PURSUANT TO AUTHORITY VESTED IN IT BY CONGRESS.

The constitutional principle which is applicable in this situation is familiar. Article VI, Paragraph 2 of the Constitution of the United States. The position of appellant as stated in the preceding section of this brief, is that the federal authority has completely "occupied the field" to the exclusion of all state action respecting depreciation accounting. We now call in question the validity of this order upon the somewhat narrower ground that it is directly in conflict with the requirements validly imposed by the Interstate Commerce Commission.

The Revised System of Accounts of the Interstate Commerce Commission required the establishment of an account to be known as "608—Depreciation," to which account shall be charged the depreciation expense applicable to the accounting period for various classes of depreciable telephone plant. The instruction with reference to this account required that "the depreciation charges shall be made in accordance with instructions 23-C, 80, 81 and 82." Exhibit 7, p. 70 (R. 214). Instruction 23-C has to do with depreciation on leased telephone plant and is not of interest here. Instruction 82 provides: "The classes of depreciable telephone plant and the accounts covering such plant are as follows:" and then lists twelve different classes of property employed in the telephone business, together with the associated account numbers (R. 213). Instructions 80 and 81 (Exhibit 7, R. 210-213) are here set out for convenient reference:

> "80. Computation and filing of depreciation rates.—(A) The company shall file with the State commission or commissions having jurisdiction, for review and recommendations to this Commission, estimates of the composite annual percentage rates considered applicable to the book cost of each class of depreciable telephone plant owned or used by the company. These percentage rates shall be based upon the estimated service values and service lives developed by a study of the company's history and experience and such engineering and other information as may be available with respect to prospective future conditions. These percentage rates shall be computed in conformity with the group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation

(note instruction 3-J), may be distributed under the straight-line method (note instruction 3-Z) during the service life of the property. Such percentage rates shall for each primary account comprised of more than one class of property produce a charge to operating expenses for that account equal to the sum of the amounts that would otherwise be chargeable for each of the various classes of property included in the account. The estimates of the composite annual percentage rates so filed shall be accompanied by a sworn statement showing the bases therefor and the methods employed in their computation. Where no State commission has jurisdiction or is willing to act in the premises, the estimates and the accompanying statement shall be filed with this Commission. A company subject to the provisions of this system of accounts January 1, 1933, shall file such estimates not later than August 1, 1933. A company which becomes subject to the provisions of this system of accounts after January 1, 1933, shall file such estimates within six months after the provisions of this system of accounts become applicable to it. After consideration of the recommendations of the State commission or commissions to the extent available, this Commission will by temporary order prescribe the composite annual percentage rates which shall be charged with respect to each class of depreciable telephone plant. After the issuance of the temporary order, opportunity will be afforded at public hearings, if desired, for the presentation of evidence by all interested parties with a view to the modification of such order and for the submission of views based on such evidence. Such public hearings shall be conducted for this Commission, so far as possible, by State commissions. The company shall be prepared at any time upon direction of this Commission to compute and submit, for its approval, revised percentage rates in cases where existing rates are deemed inapplicable.

"(B) In the event any composite percentage rate prescribed by this Commission, in the judgment of the company becomes no longer currently applicable, the company shall in a like manner file estimates of revised composite annual percentage rates which, in its judgment, should be established.

"(C) The company shall keep such records of property and property retirements as will reflect the service life of property which has been retired, or will permit the determination of service-life indications by mortality, turnover, or other appropriate methods, and also such records as will reflect the percentage of salvage value, or net salvage value, as appropriate, for property retired from each class of depreciable telephone plant.

"81. Depreciation charges.—(A) Charges for currently accruing depreciation shall be made monthly to account 608, 'Depreciation,' and account 702, 'Vehicle and other work equipment expense,' as appropriate, and corresponding credits shall be made to account 171, 'Depreciation reserve.' In computing the current monthly charges, one-twelfth of the composite annual percentage rate applicable to the primary accounts covering depreciable telephone plant shall be applied to the average of the balances, as of the first and last of the current month, in each such primary account.

"(B) In addition, when the company is responsible under the terms of a lease for depreciation of property, used but not owned, for which the rent is chargeable to account 303, 'Rent for lease of operating property' depreciation charges shall be made on the same basis as for owned depreciable property.

"(C) A separate composite annual percentage rate for each account covering depreciable telephone plant shall be used in computing depreciation charges. Such composite rates shall be those which are from time to time prescribed by this Commission, except

that where no rates previously have been prescribed for the company's use by this Commission, the company's estimates of composite annual percentage rates computed in accordance with instruction 80 shall be used prior to the date rates prescribed by this Commission become effective."

In the course of the proceedings of the Interstate Commerce Commission carried on for the purpose of complying with the requirement of the amendment of 1920 directing the Commission to prescribe rates of depreciation, supra, p. 21, it developed and established certain rules and principles for the calculation of depreciation expense. These rules and principles were set out in the report and order of the Commission in the depreciation proceedings referred to above, supra, pp. 21-22, and are embraced in the instructions found in the Revised System of Accounts which we have quoted. These, of course, have been adopted and made fully effective. At the times with which we are concerned they governed the accounting of companies subject to the system of accounts.

An examination of these principles, in accordance with which the companies are required to compute the depreciation charges to be entered upon their books, discloses certain rules which must govern such accounting. Among these requirements is that which compels the adoption of the straight-line system of depreciation accounting, by which the loss of service value of the property is spread evenly during the several accounting periods throughout the service life of the property. These instructions also require that a percentage rate be derived in accordance with this method for each of the several classes of depreciable property prescribed by the

Commission, and that this percentage be applied in the calculation of the expense of depreciation. These instructions, furthermore, directed the companies to derive appropriate percentage rates by ascertaining from a study of the company's past experience and by the use of the best information available as to future conditions the estimated service values and service lives of the several classes of property. This system of depreciation accounting is a coherent, well understood method of deriving the charges to be made upon the books of the company on account of the expense of depreciation. It is not necessary in this connection to defend it or consider its usefulness as compared with any other system of accounting for depreciation expense. It is important only to understand what it is and to point out that it is the system which appellant was required to employ.

1.

Accounting separately by classes of plant.

The Nebraska order requires that a percentage rate of 3½% be applied to all the depreciable property of the appellant in the State of Nebraska. This is to be set over against the requirement of the Interstate Commerce Commission that the company shall calculate in the method there set out a separate rate of depreciation for each of twelve different classes of telephone plant.

> "A separate composite annual percentage rate for each account covering depreciable telephone plant shall be used in computing depreciation charges." Instruction 81 (C), Exhibit 7.

The record shows that the rates of depreciation for various classes of plant vary widely as between these several classes (R. 10). It is in this regard plainly impossible to comply with both the Nebraska order and the Uniform System of Accounts. If rates are derived for each of the classes of depreciable plant by the methods directed to be used by the Interstate Commerce Commission, it plainly will be nothing except a sheer coincidence if a composite result respecting all the property of the company in the state should happen to be 3½%. Nor is there any conceivable way in which an arbitrary percentage, called a composite rate of 3½%, can be broken up into twelve components. Any such process, of course, does not produce "components," but is nothing but a process of division without any principle available to determine the process.

It may be helpful in avoiding confusion at this point if there is a clear understanding as to the proper use of the term "composite" in connection with depreciation rates. Instruction 80 of the Uniform System of Accounts, quoted above, provides:

> "Such percentage rates shall for each primary account comprised of more than one class of property produce a charge to operating expenses for that account equal to the sum of the amounts that would otherwise be chargeable for each of the various classes of property included in the account." (R. 211.)

These percentage rates for any primary account are properly to be called "composite" rates, and the term is so used in the System of Accounts. As an example, selected for its simplicity, Primary Account No. 244 covers underground conduit. This embraces two classes

of property with differing service life characteristics, namely main and subsidiary underground conduit. This is shown, together with the computation of a composite rate for the account, in the following tabulation taken from Exhibit 1 (R. 16):

NORTHWESTERN BELL TELEPHONE COMPANY
COMPUTATION OF COMPOSITE RATES FOR PRIMARY ACCOUNTS
AS OF JANUARY 1, 1934

Primary Account No. 244 UNDERGROUND CONDUIT

Kind of Property	Ledger Value (Amount)	Service Life (Years)	Net Salvage Value (%)	Annual Percentage Rates	Estimated Annual Depreciation Charge (Amount)
(1)	(2)	(3)	(4)	(5)	(6)
Main	$5,077,419	60	0	1.7	$ 86,316
Subsidiary .	1,275.357	30	0	3.3	42,086
Totals	$6,352,776	xx	xx	xx	$128,402

Total investment included in account	$6,352,776
Estimated annual depreciation charge	128,402
Annual composite rate or percentage of depreciation applicable to total of primary account (determined by dividing the total of column (6) by the total of column (2))	2.0%

On the other hand, when the Nebraska Commission orders the use of a "composite" rate of 3½% upon all depreciable property in the state, an entirely different thing is involved. Compliance with that order requires the actual application in accounting of a rate of 3½% to all depreciable property. Even if it had been intended that this rate be broken into rates for each primary account, there is no way in which this can be done except upon a purely arbitrary basis. The Nebraska Commission has used terminology which sounds as if it were intended to take account of the requirements of the Uniform System; in fact, the requirements sought to be imposed by these respective authorities are in direct conflict with one another.

The purpose of the Interstate Commerce Commission in requiring separate rates to be used for each of the classes of plant is apparent. It was not merely to make elaborate a process which might equally well be simple. In the first place it was carrying out the requirement of the statute. (Sec. 20 (5), Interstate Commerce Act, supra p. 21). Pursuant to the statute it had determined the classes of plant as to which depreciation should be accounted for. This having been accomplished, it naturally and properly followed that the accounting companies should be required to account separately for the expense of depreciation with respect to each of these classes of plant. Independently of this consideration, it is clear that the power to prescribe a uniform accounting system must include the power to require that depreciation expense be recorded separately for specified classes of property. Whatever the purpose, it cannot be doubted that it was well within the power of the Interstate Commerce Commission to prescribe this method of accounting, and the fact that it has done so is after all the only thing concerned in this connection.

2.

Straight-line depreciation accounting.

Instruction 80 (A) of the Uniform System of Accounts, First Revised Issue, Exhibit 7, provides that the percentage rates to be used shall be computed in conformity with the group plan of accounting for depreciation, "and shall be such that the loss in service value of the property • • • may be distributed under the straight-line method (note instruction 3-Z) during the

service life of the property." Instruction 3-Z, Exhibit 7, p. 5, is as follows:

> "(Z) 'Straight-line method,' as applied to depreciation accounting, means the plan under which the service value of property is charged to operating expenses and to clearing accounts and credited to the depreciation reserve through equal annual charges as nearly as may be during its service life." (R. 208.)

"Service life" and "service value" will be found defined in Instructions 3-X and 3-Y of the Uniform System of Accounts, Exhibit 7, p. 5. (R. 207.)

As a result of these requirements the system of accounting for depreciation expense is required to embrace the element of ascertaining and spreading in equal instalments throughout the service life of the property in question the total amount to be charged to depreciation expense on account of such item or group of items during its life. It is plain that this procedure once adopted must be faithfully adhered to. It is an express disavowal of this principle if it is at any time departed from, in that the essential feature of it calls for a continuous and consistent method of calculating and recording depreciation during the entire period under consideration. This does not mean that estimates previously made should not be revised if they are discovered in the light of later or fuller information or by reason of changed conditions to be inaccurate. It does mean, however, that when service life and service value have been determined upon in accordance with the best and most reliable information available, there shall be no departure at any point from the objective of spreading this sum representing the serv-

ice value evenly over the period determined to be the service life.

It is apparent that this principle is in danger of destruction if the accounting company, for whatever reason or at whatever behest, may be permitted or required for any period of time to enter amounts as depreciation expense which are other than the instalments calculated for the accounting period involved. There are other methods than the straight-line system of accounting for the expense of depreciation. It is unnecessary in this case to consider their comparative merits. What is now sought to be emphasized is that the straight-line method cannot be employed for a period, abandoned, and then resumed. When this sort of thing happens, it will necessarily result that the straight-line method, by its own definition, has not been employed at all.

This is necessarily true whether the departure from the straight-line method is voluntarily undertaken or whether it is required by some governmental authority. The Interstate Commerce Commission in its System of Accounts has prescribed this method. This being so, there can be no doubt that the authority of the federal Commission to prescribe a Uniform System of Accounts has been permitted to be attacked in a quite inadmissible manner if a state commission has the power to require accounting companies to enter as the expense of depreciation something other than the amount represented by the employment of the straight-line method of accounting.

The Nebraska order in the plainest fashion does just that. It prescribes a fixed rate for the year 1934. The straight-line method of accounting does not permit any

one to prescribe the rate for any year except as a result of the determination that such a rate will represent the proper charges for that year upon the principle of distributing the depreciation expense during the service life of the property in equal periodical charges. The report, findings and order of the Nebraska Commission clearly disclose that it has made no such determination and has on the contrary repudiated the necessity or propriety of it. The Commission, in its second finding which purports to support the order here in question, found;

> "That the factor of inadequacy arising from growth will not be as important a factor in 1934 as it has been in the past, and that respondent's proposed rate of 4.48 per cent will not be required for 1934." (R. 30.)

Under the straight-line method of depreciation accounting such a finding has no more pertinency with respect to the amount to be charged as depreciation expense in 1934 than it has during any other year of the service life of the property being the subject of depreciation accounting. An examination of the report of the Nebraska Commission makes it entirely plain that what the Commission was undertaking was not to require the accounting for depreciation upon the straight-line basis or any other basis of depreciation accounting, but on the contrary was undertaking to express in a percentage actual retirements during the current year and to bring about the charge to expense of the amount of such retirements. Of course, this is retirement accounting rather than depreciation accounting. It may be conceded, for the purpose of argument, that this is one possible way of recording the expense of property used up in

service. It is not necessary to consider whether any obstacles exist in the way of a valid requirement that this method of accounting be used by a public utility. What we are here concerned to say is that of all possible methods of dealing with this expense this method represents as extreme a departure from the requirements of the principle of straight-line depreciation accounting as any that could be contrived.

Moreover, the Nebraska Commission itself has been entirely explicit in its recognition that the order here in question is inconsistent with straight-line depreciation accounting. Its finding quoted in the preceding paragraph discloses this. Reference may also be made to a later decision of the Commission rendered November 27, 1935, purporting to fix a depreciation rate for appellant to apply for 1935. In its opinion in support of such order the Nebraska Commission referred to recommendations which it had made to the Federal Communications Commission, successor to the Interstate Commerce Commission, respecting appellant's depreciation rate, recommending an over-all composite annual depreciation rate of 3.18%, and as to this it said:

> "This was based upon company's retirements for 1933. Our purpose was to prevent a further increase of balance in account for accrued depreciation. We recognized then that we were not following the straight-line method of depreciation accounting, but the line had already been broken by the economic depression; inadequacy had ceased to be a factor in current operation. We now hold that the experience of a single year does not form a sound basis for estimating future depreciation rates." *In the Matter of Depreciation Charges for Class "A"*

and Class "B" Telephone Companies, ... P. U. R. (N. S.) .....

3.

Rates to be based on estimated service values and service lives.

Instruction 80 of the Uniform System of Accounts, referred to above, supra page 44, provides with respect to the depreciation rates to be applied to the several classes of depreciable property as follows:

> "These percentage rates shall be based upon the estimated service values and service lives developed by a study of the company's history and experience and such engineering and other information as may be available with respect to prospective future conditions."

The process of depreciation accounting prescribed by the Interstate Commerce Commission as indicated in the instructions in the Uniform System of Accounts, and as elaborated in the report in the proceeding entitled *Depreciation Charges of Telephone Companies,* Docket No. 14700, 177 I. C. C. 351, is based upon the determination by processes of calculation and estimate of the service life and service value of the particular property under consideration. With these two factors established, an annual percentage rate may be directly derived which is appropriate to be used under straight-line depreciation accounting in calculating the dollars of depreciation expense to be charged to the annual accounting period which is involved.

The order in suit of the Nebraska Commission obviously proceeds in complete disregard of this system of accounting. It prescribes an annual rate of deprecia-

tion, which it is entirely clear from the opinion which accompanied the order (R. 19, 27-28), is not produced by any process of estimating or determining service life or salvage value of the property. This opinion discloses that in so far as the determination of the depreciation of 3½% had any basis at all, it was based primarily upon consideration of the balance in the appellant's depreciation reserve account (R. p. 27). The Commission reaches certain conclusions or makes certain assumptions to the general effect that this balance is too great, and says that its purpose is "to reduce the annual depreciation rate so it will gradually bring the accrued depreciation and the depreciation reserve into a fair relationship" (R. 27). Obviously, this is not deriving percentage rates based upon the estimated service values and service lives of the property as required by the System of Accounts of the Interstate Commerce Commission.

Summarizing: The opinion and order of April 9, 1934 of the Nebraska Commission not only fail to show that the Commission took any account whatever of the requirements of the Federal System of accounts as to the calculation of depreciation expense; they not only disclose plainly that the order appealed from was made with complete indifference to the Federal requirements and with the intention of creating a situation which would make it necessary for appellant to disobey one set of instructions or the other; but they also show clearly that this conflict is inherent not only in the results of the two systems of requirements when placed in application, but in the basic underlying theory upon which they are founded.

Appellant, if it should undertake to obey the commands of both Commissions would have two records of depreciation expense, both of which cannot be true records, because they are different. Therefore it would have no record, in any proper accounting sense, because neither would purport to the exclusion of the other to be the company's record of this expense. This order is to be understood as we have dealt with it, as an attempt to override federal requirements and to place those of the state commission in their place.

IV.

THE ORDER DENIES TO APPELLANT DUE PROCESS OF LAW BECAUSE IT IS NOT FOUNDED UPON ANY EVIDENCE IN THE RECORD AND BECAUSE IT REQUIRES THE MAKING OF INCORRECT ACCOUNTING ENTRIES.

We have directed attention to the infirmities in this order which proceed from its conflict with federal authority. Independently of this, the order is a denial of due process under the Fourteenth Amendment because the record furnishes no basis for such an order.

An order of an administrative board such as the Nebraska Commission is void if made without evidence, or if based upon a finding made upon evidence which clearly does not support it.

Northern Pacific Railway Co. v. Department of Public Works, 268 U. S. 39, 44-45;

Great Northern Railway Co. v. Minnesota, 238 U. S. 340, 345;

Seaboard Air Line v. Georgia Railroad Commission, 240 U. S. 324, 327.

A.

The Order, if enforced, would deprive appellant of the right to keep accurate books of account.

The expense which a telephone company encounters by reason of the using up of its property in service is a fact. Nothing which a company can do in its accounting and nothing which public authority can do in regulating its accounting can change this fact of depreciation expense. Under the method of accounting by which this expense is recorded during the period in which the property is being used, the amount to be charged annually "is the subject of estimate and computation." *Lindheimer v. Illinois Bell Telephone Co.*, 292 U. S. 151, 167.

Apart from conflict with federal authority, it may be conceded that public regulation of accounting may properly deal with various methods and principles to be selected to govern this process of estimate and computation. This order is objectionable because it directs the use of a depreciation rate which will produce an annual charge to depreciation which is in fact and is found by the Commission to be less than the true annual charge for depreciation expense.

This is entirely clear from the opinion which is a part of the order here being reviewed. There is no evidence in this record and no finding of the Commission justifying or suggesting the conclusion that the service lives and service values of property submitted by appellant are not sound and accurate. Where the judgment of Company engineers is a factor, the Commission has not substituted its judgment. There is no room to con-

clude that the evidence introduced by the Commission, such as Exhibits 5 and 6 (R. 197-200), had not been fully taken into account by the appellant in its calculations.

The Commission makes a finding that the factor of inadequacy will not be as important a factor in shortening the life of telephone property in 1934 as it had been in the past, and therefore the depreciation rates proposed by respondent would not be required for 1934 (R. 30). Here again there is no basis whatever for any suggestion that appellant's engineers had not given full consideration to whatever bearing this fact might have upon depreciation rates. In fact, the composite of the rates filed by appellant was lower than it had ever been before, and had been declining for several years (R. 192). Moreover, the record discloses that population growth in the territory served by the appellant has been gradual and that generally in this territory the retirement of telephone property has not been influenced to any large degree at any time by a spectacular growth in population (R. 58). Thus it is clear that the two exhibits introduced on behalf of the Commission do not themselves furnish any basis at all for the order which the Commission made respecting depreciation accounting, nor does such evidence impair the force of the data which appellant was permitted or required to submit in support of the rates which it proposed using.

B.

The Order is intended to and does require the use by appellant in its accounts of a depreciation rate which was less than the true rate for the sole purpose of reducing the balance in its depreciation reserve account.

It is necessary to search elsewhere to find the real basis for the Commission's order. This is amply disclosed by the opinion which accompanied the order appealed from. There the Commission points to certain figures indicating the percentage of the depreciation reserve account balance to the total of investment in plant and equipment, which at the end of 1932 was 24.24 per cent. It may be noted that generally this percentage had been declining over a period of years (R. 192). The Commission then points to Exhibit 4, which was a copy of a summarized estimate of the valuation of a portion of the property of appellant in the State of Nebraska presented by appellant to the Commission in a proceeding during 1933 (R. 195-196). In this exhibit appellant's valuation engineer had estimated the condition per cent of the property as 88 per cent of condition new. The testimony shows that this estimate undertook simply to take account of the operation of such factors tending to decrease the value of the property as had already manifested themselves in the property at the time of the engineering inspection and did not take account of factors whose effects upon the property lay wholly in the future (R. 80-81).

Under the regulations governing the calculation of depreciation charges prescribed by the Interstate Commerce Commission it is necessary to take account of

very important factors causing the ultimate retirement of property, the effect of which cannot be discovered upon an inspection, for the simple reason that such factors have not, up to the time of the inspection, produced any effect upon the property. For instance, the destruction of property by storms, fire and other similar casualties is a substantial factor in terminating the service life of telephone property (R. 85, 172-173). Accurately calculated depreciation rates must take account of these factors. However, an inspection of the property for the purpose of determining its condition will not discover anything affecting the property attributable to casualties which have not yet occurred. A similar observation may be made with respect to retirements occasioned by invention and by public requirements, such as the necessity of removing pole lines in connection with highway changes, replacing overhead plant by underground construction and the like. Many of these causes of retirement are very important, and many of them operate suddenly, without substantial previous warning and without previous effect upon the condition of the property (R. 165).

Rates of depreciation must provide for retirement from all causes. The depreciation reserve balance represents the provision so far made for the retitrement of the present property from any and all causes which are factors in depreciation. Of course the percentage relationship of this balance to the investment in depreciable property will be different from the so-called condition per cent observed upon an inspection of the property at a given time.

The Commission, after noting these two percentage relationships, expresses its concern that what it refers

to as accrued depreciation is thus indicated to be 12 per cent, whereas the balance in the depreciation reserve account is 24 per cent. This report then proceeds to deal with the matter in the following language:

> "In ascertaining the amount required for annual depreciation it is first necessary to determine the service life of the several units of depreciable property. The factors determining service life are decay, wear and tear, physical deterioration, current action of the elements, obsolescence, inadequacy, demands of public authority and such other factors that are not restored by current maintenance. In determining accrued depreciation or percentage condition for ascertaining the fair value for rate making purposes, valuation engineers make inspection of the property to determine observed deterioration and do not give full consideration to the factors which determine the service life of the several units of property. We hold that the same factors should be considered by valuation engineers that are considered by the plant engineers and accountants in determining the required amount of annual depreciation. The differential of the respondent's actual depreciation and its depreciation reserve is probably due to this situation. The instant case presents a situation where it is the duty of the Commission to reduce the annual depreciation rate so it will gradually bring the accrued depreciation and the depreciation reserve into a fair relationship." (R. 27.)

We do not pause to do more than refer in passing to the failure of the premises in this statement to sustain the conclusion. The comment of the Commission is all in the direction of suggesting that the method of estimating service lives and service values for the purpose of depreciation expense accounting is sound and that the ascertainment of accrued depreciation for the pur-

pose of its deduction in valuation ought to conform to the same principles. The conclusion then is that the Commission should order a change in methods of depreciation accounting in order to bring this into conformity with the method of conditioning property for valuation purposes which the Commission has just found to be improper.

The disparity between the percentage of balance in the depreciation reserve account and the percentage of accrued depreciation which engineers find upon inspecting the property, was fully explained in the record (R. 80-82). Whatever bearing the matters which the Commission discusses in its report may have upon the consideration of the problem of ascertaining value in a rate case, it is clear that in the particular matter with which we are now dealing the premises found by the Commission to exist cannot in accordance with any process of orderly reasoning be brought to support the conclusion at which it arrives and upon which its order is based.

However, the exposure to view of this process of reasoning shows clearly what the Commission was seeking to do. It was undertaking to require lessened charges to be made to depreciation expense, and therefore smaller credits to the depreciation reserve account, in order to reduce the ratio which the balance in this account bears to investment in plant and equipment. The depreciation reserve account is simply an incident of the system of bookkeeping required to be employed under the Uniform System of Accounts. To this account are credited the amounts currently debited to the depreciation expense

account. When property upon which depreciation has been charged is retired, the cost of such property, less salvage, is credited to the proper plant account and debited to the depreciation reserve account. It is the balance in this depreciation reserve account with which the Commission is preoccupied, and which it seeks to reduce for the purposes above indicated.

Now it must be clear that this result can be accomplished only by requiring that the credits to this account for the future shall be less than the true periodical amounts of depreciation expense. We submit that no regulatory commission can validly for any such purpose, or for any purpose, require a company subject to its jurisdiction to record as depreciation expense amounts which are known to and intended by the Commission to be inadequate.

If it were true that the balance in the depreciation reserve account was larger than it should have been under proper depreciation accounting, this would necessarily be the result of crediting to the depreciation reserve account amounts which should have been credited to surplus. We do not understand that this court has ever given its approval to any contention that charges in current accounting for depreciation should be either more or less than the true amounts of such expense. Compare *Board of Public Utility Commissioners v. New York Telephone Co.*, 271 U. S. 23, 30-32; *Knoxville v. Knoxville Water Co.*, 212 U. S. 1, 13-14. Whatever may have been the course of things in the past, it must be both the right and the duty of the company as respects its current accounting to keep correct rather than incorrect records of the transactions being accounted for.

In fact, the record in this case furnishes no basis whatever for the view that the balance in the depreciation reserve account was not entirely proper and the inevitable result of proper accounting. The record shows that what the relationship ought to be between the amount of this balance and the total investment in depreciable property depends upon the age distribution of the property, and no intelligent view can be had as to this matter without elaborate studies (R. 57-58). At the time of the making of the order here in question, the Interstate Commerce Commission had required the making of such a study, and it was in process of being carried forward at the time of the hearing (R. 57). The evidence also disclosed that if proper depreciation charges are made, taking account of the situation of appellant's property at the time of the hearing, it would be inevitable that the ratio of the balance in the depreciation reserve account to investment would increase from that time forward for a considerable period (R. 184). This is because the appellant has a relatively large recent investment in buildings, conduit, dial central office equipment and toll terminal equipment. Retirements from this class of property have been small up to this time and will continue to be relatively limited for a considerable period (R. 182-183). Depreciation is charged upon the investment in this class of property in the meantime, and is credited to the depreciation reserve account. It is apparent that it must be so charged if there is to be a

balance in the account against which it may be charged upon ultimate retirement. Consequently, this characteristic of the appellant's situation is such as to cause the reserve balance to increase over a substantial period of time, and appellant's engineer pointed out that this must be expected (R. 183).

If the principle of straight-line depreciation accounting is admitted, the only relevant factors are the estimated service life of the property and its service value, i. e., its cost less net salvage. If these are known or reliably estimated the annual depreciation rate is a simple calculation. Appellant's depreciation rates are computed upon the basis of such engineering intelligence and judgment as it is possible for appellant to bring to bear on this problem. We submit that there is nothing in this record to furnish any basis for doubting their soundness. Of course, they deal with the future, and it is not pretended that events as they happen may not call for re-examination. In fact, such re-examination is constantly being made. Upon the premises indicated, however, we respectfully urge that carefully calculated and estimated rates of depreciation are not to be disturbed upon the basis of considerations having no more relation to the subject of inquiry than those which are expounded by the Nebraska Commission in the order and opinion involved in this appeal.

CONCLUSION

Upon each and all of the grounds above set forth, it is respectfully urged that the judgment of the Supreme Court of Nebraska should be reversed.

Respectfully submitted,

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